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SUBJECT: SCENESETTER FOR DEPUTY SECRETARY'S TRIP TO MEXICO
OCTOBER 28 - NOVEMBER 1

Classified By: CDA Leslie A. Bassett. Reason: 1.4 (b),(d).

¶1. (C) Ambassador Garza and Mission Mexico warmly welcome you to Mexico City. Your visit is an opportunity to underscore the broad, deep relationship between the U.S. and Mexico and our appreciation for Calderon's demonstrated leadership. His administration is prioritizing security and economic growth through an ambitious federal campaign to combat organized crime and implement structural reforms designed to promote competitiveness. The most important challenges his government faces are maintaining the upper hand in the battle against violent crime and making greater headway against poverty and its accompanying social ills. The U.S. and Mexico continue to expand the solid set of institutional relationships that allow us to work productively on common priorities, even as tensions surrounding immigration issues lead some Mexican political leaders to approach the bilateral relationship in more insistent tones.

Security First

¶2. (C) Mexico is key to USG success in combating trafficking in drugs, persons, arms and precursors, terrorism, and other transnational threats. Since entering office last December, Calderon's government has moved with unprecedented speed to improve public security, not waiting for the USG and often taking us by surprise. Specific measure include: launching aggressive anti-drug operations into ten states; raising pay for the military; replacing numerous high-ranking federal police officers in an anti-corruption campaign; launching a billion dollar project to create real-time interconnectivity between all police and prosecutors, as well as a unified national crime database; and, proposing congressional bills to unify federal police forces and reform the judicial system. The GOM has greatly strengthened law enforcement cooperation with the USG, while a more flexible attitude by the courts has allowed for the extradition of a record 72 criminals to the U.S. this year, already exceeding 2006's record level. The GOM is now extraditing cartel kingpins of significance and has seized record hauls of cocaine, methamphetamine precursors, and bulk cash and other assets.

¶3. (C) The ongoing security campaign has reduced the broad geographic range and legal impunity which the cartels have traditionally enjoyed in Mexico, although progress is tenuous and uneven. Addressing personal security challenges ranks regularly as the number one priority in public opinion polls, and the most recent polls show that 83% of the public supports military involvement to fight drug-traffickers. While some Mexican pundits worry that the campaign so far represents more "smoke and mirrors" than a meaningful reduction in organized crime, in fact Calderon has accomplished more in his first year than almost any other recent Mexican president in countering unlawfulness and murder. But the human price Mexico has paid has been high: in the past 10 months, almost 250 police and military

officials have been killed. Mexican political leaders are not shy about reminding us that U.S. demand for drugs, money laundering, and illegal arms flows from our side of the border help fuel Mexico's drug war.

14. (C) Members of the political opposition and human rights groups have expressed concern about the continued use of the military for internal security and the potentially corrupting influence this fight poses to the institution. The semi-autonomous National Human Rights Commission (CNDH) has investigated and reported on several incidents which occurred in the course of military operations. To date, the Secretariat of Defense has shown a willingness to deal with

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abuses committed by soldiers, including investigating individuals accused of violations in the state of Michoacan and prosecuting soldiers who killed a family at a roadblock in the state of Sinaloa. A number of outstanding allegations remain pending investigation.

15. (C) EPR attacks on Pemex pipelines in July and early September have added another dimension to Mexico's security concerns, raising the specter of home-grown terrorism. Despite GOM protests to the contrary, it seems inevitable that the military and civilian security forces will divert resources to protect the pipelines and other major assets from future attacks, which might also contaminate the investment climate. Continued criminality and violence countrywide (directed with virtual impunity) and now a new spate of guerilla activity will pressure the government to show it retains the upper hand and can overcome these threats. Calderon also recognizes that Mexico's own southern border remains extremely vulnerable to immigration, trafficking in persons, and the smuggling of contraband, and that securing this border is of vital importance to U.S.

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security.

Competitiveness is the Key

16. (C) The Calderon administration has registered some impressive economic accomplishments during its first year, maintaining macroeconomic stability, keeping inflation at a reasonable 4% for 2007, and lowering barriers to trade. The president secured congressional approval of the 2007 budget, and won passage of an unpopular but necessary government workers' social security reform. His effort to reform Mexico's tax system paid off September 14 when Congress approved a tax reform that will boost government revenues by 2.1% of GDP by 2012. This string of victories will help ensure sufficient government revenue to meet rising health and pension commitments, but is not enough to ensure sufficient revenue in the medium term as oil production continues to decline. Much remains to be done to arrest Mexico's slipping global competitiveness. Mexican growth will likely register a disappointing 3% in 2007. The GOM's challenge is to implement structural reforms required for growth sufficient to raise 40% of Mexicans out of persistent poverty.

17. (C) Oil revenues cover 40% of the government budget. While high oil prices are providing a temporary reprieve, they are also distracting officials from the hard task of energy reform. If current trends continue, Mexico will run out of oil in eight to 10 years. Mexico likely has sufficient oil reserves, but lacks investment capital and know-how to extract much of it, especially deep water reserves. Reversing dangerously declining oil production would require a genuine energy reform to end the constitutional ban on private sector involvement in the petroleum sector. Many doubt this country is ready to overcome the strong nationalist taboo on private investment

in oil. Mexico also needs to address the detrimental impact its monopolies and oligopolies have on competitiveness, entrepreneurship, and foreign investment.

¶8. (C) Calderon has demonstrated limited readiness to take on Mexico's powerful media companies, and the somewhat strengthened Federal Competition Commission is standing up in some areas to TELMEX (the private sector telecom monopoly owned by Carlos Slim). Yet it remains to be seen to what extent Calderon is prepared to take on entrenched monopolies, especially those that helped contribute to his election in ¶2006. The GOM needs to curb labor rigidities and rampant infringement of intellectual property rights -- both of which negatively affect the country's business environment and job creation. Meaningful education reform is essential to prepare Mexican youth for the 21st century. Yet Calderon has so far proved reluctant to move on this front, in part given his alignment with the powerful teachers' union leader Elba Esther Gordillo.

Environmental Issues

¶9. (SBU) Despite Calderon's criticism of the U.S. climate change record, he remains committed to cooperating with us, and sees Mexico as a natural bridge between the developed and developing worlds on this issue. On water, Mexico has finally delivered the remaining 14 percent of Rio Grande water owed the U.S. for the 2002-2007 water cycle under the 1944 Treaty. Our job now is to raise the priority of these deliveries in Mexico's next Rio Grande water allocation plan. In the West, the International Boundary and Water Commission (IBWC) is exploring with Mexico how we can reduce allocations from the Colorado River to be compatible with the ongoing drought in the area.

A President with Increasing Political Capital

¶10. (C) Having completed nearly 11 months in office, Felipe Calderon has crafted an image as an activist president, consolidating his own political position and the power of the Mexican state -- no small feat given tensions surrounding the 2006 elections and the law enforcement challenges the country faces. The president is known for excellent political instincts and is choosing his battles carefully, moving forward on priorities in a way commensurate with his political capital. It will take some time before the full impact of his security and economic initiatives is known, but Calderon has in his favor 68% personal approval ratings and impressive political skills. Additionally, Mexico's

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legislature has demonstrated increasing political maturity and begun to advance critical bills.

¶11. (C) Yet the political climate here remains conflictive, with the PRI willing to negotiate with the president's party only when convenient and the PRD seeking to exact steep concessions to overcome its predisposition to block legislation. Some observers worry that the president is not pushing hard enough for comprehensive reforms and that PAN collaboration with the PRI, where it occurs, will further entrench the economic privileges Mexico's elites have long enjoyed at the expense of Mexico's democratic institutions and long-term development. Although considerably weakened as a result of its confrontational tactics, the PRD can still slow Calderon's momentum. The leftist party remains a voice for millions of Mexicans trapped in poverty, and the simmering social tensions that fed the candidacy of failed presidential hopeful Andres Manuel Lopez Obrador have hardly evaporated. Prosperity ranks with security as the key priority in the minds of most Mexicans. If his programs and policies prove unsuccessful in generating the kind of growth necessary to create sufficient jobs and reduce poverty,

Calderon could quickly find himself vulnerable to a reinvigorated political opposition. All three of the main political parties have their eyes on bellwether 2009 congressional elections.

U.S.-Mexico Relations

¶12. (C) The Calderon government has demonstrated pragmatism in its posture toward the United States and bilateral cooperation, particularly in law enforcement, has never been stronger. However, the failure of immigration reform in the United States was a political setback for the president. The result is that he enjoys less political space in which to openly cooperate with the U.S. on issues of mutual bilateral importance, and the GOM is careful to term any discussion of security cooperation as an outcome of our common struggle against organized crime rather than as assistance. Your visit is an opportunity to outline security cooperation, and demonstrate that despite occasional tensions in the relationship over issues like immigration, bilateral ties are deepening and expanding to the good of both our societies. It will also be a reassuring sign of our dedication to one of our most important hemispheric allies and support for the Calderon administration.

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